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COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF PUBLIC INSTRUCTION
BUREAU OF PROFESSIONAL LICENSING

C. P. A. EXAMINATION QUESTIONS

1936

[Bulletin no. 622]

Issued by
STATE BOARD FOR THE EXAMINATION
OF PUBLIC ACCOUNTANTS

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STATE BOARD FOR THE EXAMINATION OF PUBLIC ACCOUNTANTS

PENNSYLVANIA STATE BOARD EXAMINATION QUESTIONS, NOVEMBER 1936

EXAMINATION IN GENERAL ACCOUNTING

Thursday, November 5, 1936 from 9 A. M. to 1 P. M.

Note to Candidates—Mere answers to questions do not provide sufficient evidence of ability. An air of appearance of professional workmanship is desired—including neatness, absence of amateur performance, set-up of answers, and clearness of explanations.

No. 1. Under the Social Security Act of 1935 there are certain requirements respecting payroll taxes that are applicable both to employers and employees.

Write the President of the Barnhill Printing Company a set of instructions for handling details under the Act. Outline the requirements, the method of keeping track of these details, the accounts to be opened, and brief explanations of the forms and records.

No. 2. Describe a system of accounting and procedure for the Big Cleaning and Dyeing Company to care for and control sales, accounts with customers, collections of work, deliveries of completed work, and cash receipts. Explain the forms to be used but do not rule them up.

Upon investigation you find that their business is divided into three (3) groups, namely:

(1) Cleaning and Dyeing for individual customers
 (a) Goods collected and delivered
 (b) Goods left at branch stores
(2) Cleaning and dyeing for tailors whose work is collected and delivered by drivers
(3) Cleaning and dyeing on contract for apartment houses, hotels, clubs, etc.

The terms of service to individual customers are C.O.D. or charge, bills due the 10th proximo, while the terms to tailors require payment on Monday for work delivered during the previous week. Contract jobs are subject to special terms. The company operates five branch stores, five trucks for individual customers and twenty trucks for tailors.

No. 3. The Directors of the Production Manufacturing Company, a new client, have requested you to certify its balance sheet, presented to you as follows:

BALANCE SHEET, NOVEMBER 1, 1936

ASSETS

Current Assets		
Cash in bank and on hand	$ 50,000.00	
Cash in closed bank	12,000.00	
Accounts and notes receivable	170,000.00	
Inventories	250,000.00	
		$ 482,000.00
Fixed Assets		
Land, buildings and equipment	830,000.00	
Patents and trade marks	100,000.00	
		930,000.00
Investments		200,000.00
Deferred Charges		145,000.00
Total		$1,757,000.00

LIABILITIES AND CAPITAL

Current Liabilities		
Notes payable	$ 84,000.00	
Accounts payable	95,000.00	
Accrued taxes	10,500.00	
Accrued interest	4,500.00	
		$ 194,000.00
Mortgage Payable		150,000.00
Capital Stock and Surplus		
Capital stock	1,250,000.00	
Surplus, November 1, 1936	163,000.00	
		1,413,000.00
Total		$1,757,000.00

Your examination, made for the purpose of certification, developed the following facts with respect to the foregoing balance sheet.

Cash includes:

Post-dated checks of customers in the sum of $3,750.

Checks (in payment of accounts payable) listed as outstanding but still on hand, $12,250.

Closed bank holding $12,000 will ultimately pay in full.

Accounts and Notes Receivable:

Notes of companies in which officers are interested, which have eighteen months to run, $25,000.

Officers' and employees' advances of $2,000.

Notes of customers, $3,500 which are all past due.

Accounts totaling $15,000 representing consignment shipments billed at cost.

About one-third of customers' accounts are past due.

The customers' accounts included are shown net of the reserve of $15,255 or 13½% for bad accounts.

Notes of customers for the sum of $10,000 maturing subsequent to November 1, 1936 have been discounted with banks.

Inventories of $250,000 include:

Flasks and patterns revalued at $75,000 by reason of use in production.

Merchandise received on consignment at billing price of $15,000 to be paid for as used in connection with own production.

Raw material, work in process and finished goods are carried at cost.

Fixed Assets:

Land which cost $15,000 was written up after purchase to $30,000.

Buildings and equipment are shown net after depreciation of 20% of their cost.

Patents and trade marks are net after amortization to October 31, 1936.

Investments include:

10,000 shares of Treasury Stock acquired in July, 1936 in return for cancellation of amounts totaling $80,000 due from officers, at which sum the shares are carried on the books. The minutes indicate that these shares are to be retired.

350 shares of stock of the Ibid Company acquired at par of $100 per share and carried at $35,000. All the remaining $65,000 of capital stock of this company is owned by officers of the Production Manufacturing Company.

1,000 shares of stock of the Simplex Pattern Company acquired at $5.00 per share, being all the outstanding stock of that company, whose financial statement shows a book value of $7.50 per share as compared with the par value of $10.00 per share.

Various listed stocks having a market value of $37,000 acquired and carried at cost, viz., $51,000.

U. S. Treasury bonds having a par value of $25,000 acquired and carried on the books at 101. The market value at November 1, 1936 was 103.

Cash surrender value of $50,000 policy on life of the president of the Production Manufacturing Company was $3,750.

Deferred Charges include:

Unexpired insurance premiums of $3,450.

Organization expense of $1,550.

Cost of disallowed patent applications $40,000.

Good will set-up in connection with organization of the Company, $100,000.

Notes Payable include:

Past due notes to creditors for $24,000.

Demand notes of $15,000 given to officers for salaries.

Notes to bank for $45,000 which are secured by collateral in the form of the listed stocks and U. S. treasury bonds owned by the company.

Accounts Payable include:

Payroll of $8,000 for period ended October 31, 1936.

Credit balances of $12,000 in employees' accounts.

Advances of $15,000 on customers' sales contracts not yet billed or produced.

Accrued Taxes and Interest were correct as shown.

Mortgage Payable:

This is a 6% mortgage for $150,000 dated May 1, 1931, payable $2,500 at each semi-annual interest date. Interest has been paid or accrued to October 31, 1936, but no payments have been made on the principal.

Capital Stock:

The company has a Pennsylvania charter dated January 1, 1931. The authorized capital stock consisting of 100,000 shares having no par value, was all disposed of at $15.00 per share. The minutes specify that the stated value per share is $10.50.

Surplus:

The company has been in operation since January 1, 1931, and showed an aggregate loss of $103,000 for the years 1931 to 1934 inclusive. In 1935 a profit of $14,000 was made and for 1936 to date, a profit of $12,000.

A dividend of 25 cents per share was paid in 1935 and on October 15, 1936, a dividend of 15 cents was declared and made payable November 15, 1936.

Required: Prepare a balance sheet to which you can properly certify, limiting yourself to two simple footnotes and making any other necessary explanatory notes as briefly as possible immediately adjoining the various items in the balance sheet. The balance sheet is to be all-inclusive; that is to say, exhibits or references thereto as accompanying the balance sheet are not acceptable. (The certificate itself is not required as part of the solution of this problem.)

No. 4. (1) The books of the Good Work National Bank are posted daily, with Income and Expense accounts closed to Profit and Loss account semi-annually on May 31st and November 30th, the end of the fiscal year. Accounts are kept on the basis of cash receipts and disbursements, with the exception that interest on demand loans is recorded as income when billed, and charged to Uncollected Interest, which account is credited as payment is received. Federal Income Tax Returns are filed by calendar years on a cash receipts and disbursements basis. You are retained in October to change the method of accounting to the accrual basis, and from the fiscal year to the calendar year.

(a) At what date would you make the change effective and how would you accomplish the desired result? Indicate the adjusting entries, using your own figures and account titles.

(b) What steps would you take to change the basis of the Federal Income Tax Return? What adjustments are required for the first return on the accrual basis?

(2) Upon completion of the above assignment, the bank retains you to make examinations during and throughout each year, at such times and to such extent as you may decide. Deposits aggregate $8,000,000 and two branch offices are maintained in addition to the main office. There is no trust department. You must submit to the Board of Directors a certified statement of condition as at the date of each call by the Comptroller of the Currency. Your annual fee is limited to $1,500.

(c) Describe the type of examinations you would make and state the number of examinations and the months you would cover in each.

EXAMINATION IN GENERAL ACCOUNTING

Thursday, November 5, 1936 from 2 P. M. to 5 P. M.

No. 5. In the course of making an audit for the fiscal year ended April 30, 1936, you find that your client, a manufacturer of corrugated paper containers, had sustained considerable flood damage in March, 1936, and in connection therewith you determine the following facts:

(1) Damaged office equipment which originally cost $3,150, against which depreciation of $2,205 has been reserved to date (including $315 taken for 1935-36), was sold as scrap for $125, and the latter amount was included in merchandise sales. These items are still carried in the equipment and reserve accounts, the cost of the items purchased on March 29, 1936, to replace them ($2,700) having been charged to Flood Damage.

(2) Completed containers destroyed by water were given without charge to a scrap dealer. The inventory value of these containers, prior to the flood, was $7,800, computed approximately as follows:

Material	$4,500
Labor	2,000
Overhead	1,300

No entry for the above item was made on the books, nor was it included in the closing inventory.

(3) Paper roll stock material, which became wet, originally weighed 800 tons, and cost $50 per ton. These rolls were "stripped" down to a point where they were workable on the corrugator and the damaged sheets sold for $875, the latter figure being included in merchandise sales.

The partial rolls remaining, or "butts," were listed in the closing inventory at 600 tons having a total value of $30,000. In discussing this item with the plant manager, you learn that the "butt" weights, as shown in the above closing inventory

(which is not yet on the books), include excess moisture content, due to absorption, averaging 10% of such weights. The officers of the company, however, ask you not to make any change in the inventory value of this item, if possible, due to the fact that they anticipate higher income tax rates during the coming year.

(4) The officers of the company advise you that although they believe that all the flood expenditures have already been made, it is possible that other items may arise in succeeding months. They desire your opinion, therefore, as to the advisability of setting up a Reserve for Flood Damage of, say, $5,000 to be claimed as a deduction for income tax purposes in the fiscal year just ended.

(5) The company lost several valued customers to competitors due to inability to fill orders promptly after the flood and it is suggested to you that an entry charging Flood Damage Account and crediting the Goodwill account for $5,000 would secure an additional tax deduction of that amount.

Required: State how you would handle the questions involved in paragraphs (1) to (5) inclusive.

In answering the problem, keep in mind that your client desires an unqualified balance sheet and has therefore held the books open so that you can make any adjustments you might consider necessary. Use the paragraph numbers in stating your answers, and where you consider adjustments necessary show the required journal entries with appropriate explanations. The company does not maintain a cost system.

No. 6. (a) From the figures shown below, representing the debts and offsetting assets of the X County, situated in Pennsylvania, prepare a statement showing separately the remaining borrowing power, if any, of the Commissioners without assent of Electors, and the borrowing power with the assent of Electors, based upon the last preceding assessed valuation as indicated below:

INDEBTEDNESS

Bonds Authorized and outstanding:		
Electors' Bonds	$2,500,000.00	
Commissioners' Bonds	1,900,000.00	
		$ 4,400,000.00
Accrued interest on Commissioners' Bonds		14,500.00
Unpaid property damage awards on Commissioners' Bond Projects		25,000.00
Accrued interest on damage awards		2,250.00
Unpaid estimates on contracts (Commissioners' Bonds)		125,500.00
Note payable (General Fund)		40,000.00
Unpaid operating payroll		13,750.00
Accounts payable (budgeted)		15,250.00
Total indebtedness		$ 4,636,250.00

OFFSETTING ASSETS

Cash:		
Sinking Funds (Electors' Bonds)	$ 400,000.00	
Sinking Funds (Commissioners' Bonds)	375,000.00	
Electors' Bond Funds	400,000.00	
Commissioners' Bond Funds	245,000.00	
General Fund	27,500.00	
		$ 1,447,500.00

Investments (Electors' Bonds Sinking Funds)	$ 850,000.00
Unpaid assessments against property owners (Commissioners' Bond Projects)	48,000.00
Accrued interest on assessments	4,320.00
Delinquent and liened taxes collectible	275,000.00
Accrued interest on delinquent and liened taxes	37,245.00
Sundry accounts receivable (good)	13,000.00
Supplies inventory (operating)	27,500.00
	$ 2,702,565.00
Last preceding assessed valuation	$56,000,000.00

Article 9, Section 8 of the Constitution of Pennsylvania provides in part as follows:

"The debt of any county, city, borough, township, school district, or any other municipality or incorporated district, except as provided herein, and in section fifteen of this article, shall never exceed seven (7) per centum upon the assessed value of the taxable property therein, but the debt of the city of Philadelphia may be increased in such amount that the total city debt of said city shall not exceed ten per centum (10) upon the assessed value of the taxable property therein, nor shall any such municipality or district incur any new debt, or increase its indebtedness to an amount exceeding two (2) per centum upon such assessed valuation of property, without the consent of the electors thereof at a public election in such manner as shall be provided by law * * *."

(b) Prepare a 1936 Budget Statement for a School District in Pennsylvania, any one that you may select. Use your own figures for both income and expenditures.

No. 7. A Real Estate Broker brought you a problem in connection with the sale of a property in which he represented the owner, a resident of Pennsylvania. His principal had agreed to accept as part of the consideration a mortgage executed by the purchaser, an individual, for $300,000, with interest at a rate per annum, for the term of the mortgage, which will yield 3% net on his investment (after allowing for the deduction of personal property taxes at rates in effect January 1, 1936). He wants to receive consecutive equal annual payments of approximately $15,000 covering interest and reduction of principal, which is to be paid in full within the number of years required; the first payment will be due one year after date of the mortgage, and each subsequent payment one year later. You are asked to fix the term of the mortgage in complete years and to determine the exact annual payment and the interest rate required to meet the conditions set forth.

Note: You are to determine the length of time necessary to pay off in equal annual instalments this $300,000 mortgage and interest thereon at the required rate.

The present worth of an annuity of $1.00 for any period from 30 to 40 years at rates of 3%, 3½% and 4% is shown in the following table:

	3%	3½%	4%
30	19.60044135	18.39204541	17.29203330
31	20.00042849	18.73627576	17.58849356
32	20.38876553	19.06886547	17.87355150
33	20.76579178	19.39020818	18.14764567
34	21.13183668	19.70068423	18.41119776
35	21.48722007	20.00066110	18.66461323
36	21.83225250	20.29049381	18:90828195
37	22.16723544	20.57052542	19.14257880
38	22.49246159	20.84108736	19.36786423
39	22.80821513	21.10249987	19.58448484
40	23.11477197	21.35507234	19.79277388

(a) What is the life term of the mortgage? Show calculations.

(b) What is the amount of the annual payment, combining interest and reduction of principal? Show calculations and the journal entries on the seller's books for the first two years.

(c) Assume that the mortgage for $300,000 was the entire consideration in the foregoing transaction; that the depreciated cost to the seller was $25,000; that the property has been held for eleven years; and that the mortgage is dated June 15, 1936:

What profit would you report on the seller's Federal Income Tax Return for 1936? For 1937? Explain fully.

No. 8. The following is a profit and loss statement of the Simplex Manufacturing Corporation, a Pennsylvania corporation, for the calendar year ended December 31, 1936.

Sales		$1,000,000.00
Cost of sales		620,000.00
Gross profit		$ 380,000.00
Selling Expense:		
Sales salaries	$ 30,000.00	
Advertising	5,000.00	
Traveling	12,000.00	
Shipping, freight and hauling	80,000.00	
Sales office supplies	4,000.00	
Association dues	2,000.00	
Telephone and telegraph	2,400.00	
Miscellaneous expense	3,000.00	
		138,400.00
		$ 241,600.00
General and Administrative Expense:		
Executive salaries	$ 56,000.00	
Office salaries	14,000.00	
Telephone and telegraph	2,000.00	
Printing and stationery	3,000.00	
Legal and accounting fees	2,800.00	
Interest	3,000.00	
Life insurance premiums (on policies payable to company)	2,600.00	
Donations	1,800.00	
Bad debts	4,000.00	
Federal income tax (paid)	12,000.00	
Federal capital stock tax (on value declared June 30, 1936)	1,000.00	
Pennsylvania state taxes	8,200.00	
Federal payroll tax	4,000.00	
Miscellaneous	9,000.00	
		123,400.00
		$ 118,200.00

Other Income:		
Dividends received	$ 2,000.00	
Discounts earned	4,000.00	
		$ 6,000.00
Net profit		$ 124,200.00
Dividends Paid:		
March 31, 1936	$ 30,000.00	
September 30, 1936	60,000.00	
		90,000.00
Net profit to Surplus		$ 34,200.00

Required: How much Federal tax will this company be required to pay on its earnings for the year 1936?

Note: (1) Show your calculations in detail, starting with the net profit per books, including the adjustments required to determine taxable income, and then proceed with separate computations of the various Federal taxes involved.

Note: (2) Although the Pennsylvania corporate income tax for the current year is a permissible accrual in arriving at the net income for Federal tax calculations (while conversely, the Federal tax may be deducted in computing the State tax), nevertheless for the purpose of simplicity this feature may be ignored in working out the solution to this question. In other words, consider the current year's State income tax to be properly reflected in the profit and loss statement as shown.

EXAMINATION IN GENERAL ACCOUNTING

Friday, November 6, 1936 from 9 A. M. to 1 P. M.

No. 9. The directors of the Popular Finance Company, incorporated in Pennsylvania in 1925 to operate under the Small Loans Act, have requested you to make an audit of its books which are kept on a cash basis, for the year ended June 30, 1936.

You set up the audit program and build up general data, including:

(a) Trial balances before closing as of the end of the last three fiscal years, viz.:

Accounts	*June 30, 1936*	*June 30, 1935*	*June 30, 1934*
Debits:			
Loan receivable	$205,000.00	$200,000.00	$195,000.00
Expense	2,300.00	1,900.00	2,200.00
Rent	1,200.00	1,200.00	1,200.00
Salaries	5,500.00	5,500.00	5,500.00
Dividends	10,000.00	12,500.00	20,000.00
Furniture and fixtures	2,500.00	2,500.00	2,500.00
First National Bank (Cash)	5,400.00	4,900.00	5,300.00
Properties	32,600.00	30,600.00	28,600.00
Taxes	4,200.00	3,300.00	4,500.00
Currency on hand	2,100.00	2,100.00	2,100.00
Notes receivable	2,500.00	2,500.00	2,500.00
Mortgages receivable	15,100.00	15,100.00	20,300.00
Totals	$288,400.00	$282,100.00	$289,700.00
Credits:			
Notes payable	$ 12,500.00	$ 7,500.00	$ 5,000.00
Capital stock	250,000.00	250,000.00	250,000.00
Interest earned	25,700.00	23,300.00	31,200.00
Surplus	200.00	1,300.00	3,500.00
Totals	$288,400.00	$282,100.00	$289,700.00

(b) Volume of loans and collections, last 3 years, etc., viz.:

	Number of Loans Made	*Amount of Loan Made*	*Collections*
1933-34	1,100	$180,000.00	$175,000.00
1934-35	1,500	208,000.00	203,000.00
1935-36	1,700	215,000.00	210,000.00

AGE ANALYSIS OF LOANS, JUNE 30, 1936

Year Loan Made	*Amount*
1927-28	$ 2,000.00
1928-29	5,500.00
1929-30	7,500.00
1930-31	10,500.00
1931-32	12,000.00
1932-33	15,000.00
1933-34	25,000.00
1934-35	21,000.00
1935-36	106,500.00
Total	$205,000.00

Notes Receivable

Consolidated notes represent loans made in 1930 and 1931 to a now deceased borrower and represent a claim against his estate—$2,500.

Mortgages Receivable

Mortgages taken in 1933 and 1934 to protect loans to borrowers, varying from $500 to $2,000, as well as direct mortgage loans. Reduction of $5,200 in 1935 was made possible by acceptance of HOLC bonds. HOLC loans were refused on the remaining mortgages as the total appraised value was only $7,800 as compared with the book value of $15,100.

Properties

Properties represent dwellings taken over by foreclosure proceedings on default of loan repayments. No properties have been taken over since 1932-33. The increase in the balance of this account arises from the excess of current upkeep and taxes over rents received from tenants. A recent appraisal of these properties showed a total value of $21,000, as compared with a book value of $32,600.

(c) The Loans Policy:

The company, under its charter, makes loans up to $300 on notes payable in monthly instalments with a maximum maturity of 12 months. Borrowers must have their notes signed or endorsed by a guarantor and ordinarily no collateral is required. Where collateral is taken a guarantor is not required. The rule in respect of limiting the borrowers to total loans of $300 has not been enforced, various subterfuges being permitted to surmount that requirement. The company manager is the sole judge in making loans and he has been lax in restricting guarantors to their proper credit limitations.

Interest of 10% of the original amount of the loan is charged, being prorated monthly over the life of the notes. Only interest actually collected is taken into income. When notes are recorded as judgments to protect the loans, no change is made in the interest rate.

Notes which have not been paid at maturity are frequently refinanced in amounts which enable the borrowers to pay off the old notes and accrued interest. A charge of $1.00 is made for this service, earnings from this source being concealed in the interest earned account.

From time to time mortgage loans as high as $2,500 have been made to refinance small loans for guarantors who were unable to meet defaulted notes. Direct mortgage loans in excess of $300 have also been made. Subsequent foreclosures have resulted in a number of instances.

Required:

(1) Prepare an audit program, using as sub-headings the accounting records you would expect to find in the company's office. There are several branches.

(2) Discuss briefly the following points in connection with the trial balance and general data outlined above:

(a) Comparative net earnings as indicated for the years shown.

(b) Following down the trial balance, state what factors have apparently been overlooked which would materially affect the net earnings, exclusive of accruals.

(c) The dividend policy of the company.

(d) The loan policy of the company.

No. 10. The Popular Department Store of Philadelphia has "Cash on hand and in Banks—$136,540.25" at the close of its fiscal year, August 31, 1936.

(a) Describe the procedure and steps to be taken in making a complete verification of this cash.

(b) And in auditing the cash receipts and disbursements for the year.

(c) Prepare a set of instructions for a suitable "internal check" on cash for use in this store in the future.

No. 11. You have been engaged to make an audit of the Hardware Stores Company as of October 31, 1936. The trial balance of this company on that date is:

	Debits	*Credits*
Accounts payable	....	$ 23,000.00
Accounts receivable	$ 65,000.00	....
Advertising	5,000.00	....
Bad debts	2,000.00	....
Bank discount	500.00	....
Capital stock	....	50,000.00
Cash in bank	3,500.00	....
Cash on hand	850.00	....
Delivery equipment	1,230.00	....
Discount on purchases	....	6,570.00
Dividends	15,000.00	....
Electricity	1,500.00	....
Freight, parcel post and express	1,900.00	....
Heat	700.00	....
Improvements	5,000.00	....
Insurance	2,000.00	....
Interest	250.00	....
Notes payable—Bank	....	10,000.00
Notes payable—Trade	....	5,000.00
Office expense	2,400.00	....
Office furniture	1,500.00	....
Petty cash	100.00	....
Prepaid insurance	900.00	....
Purchases	346,000.00	....
Rent	6,000.00	....
Reserve for depreciation on delivery equipment	....	380.00
Reserve for depreciation on office furniture	....	300.00
Reserve for depreciation on store fixtures	....	850.00
Sales	....	348,000.00
Store fixtures	2,500.00	....
Surplus	....	59,630.00
Taxes	4,400.00	....
Traveling expenses	1,500.00	....
Wages	34,000.00	....
Total	$503,730.00	$503,730.00

In the course of your audit you discover the following additional facts:

(1) Advances to officers of $15,000 are included in the Accounts Receivable.

(2) There is included in the Accounts Receivable $5,000 of accounts which are extremely doubtful of collection, of which $2,000 represents accounts of a period prior to November 1, 1935, which were even doubtful of collection on that date.

(3) The bad debts charged off during the fiscal year ended October 31, 1936, represent accounts owed in previous years, which were doubtful of collection on November 1, 1935.

(4) The insurance policies carried by the business are on an annual basis, and are issued as of July 1st of each year.

(5) The Notes Payable to banks represents a note discounted which will mature on November 30, 1936.

(6) The Notes payable to Trade Creditors represents the following notes, which bear interest at the rate of six per cent (6%).

Dated	*Maturity*	*Amount*
October 16, 1936	November 15, 1936	$1,200.00
September 30, 1936	November 30, 1936	1,200.00
September 15, 1936	December 15, 1936	2,000.00
September 1, 1936	December 30, 1936	600.00

(7) An analysis of the tax account reveals the following taxes which have been charged to this account:

(a) Pennsylvania capital stock	$ 600.00
(b) Federal capital stock	200.00
(c) Federal income	3,600.00

(8) An analysis of the Wages Account reveals the following distribution of wages:

	11/1/35 *to* 12/31/35	1/1/36 *to* 10/31/36
Department A	$ 750.00	$3,750.00
Department B	350.00	1,650.00
Department C	500.00	2,500.00
Delivery	400.00	2,100.00
Storeroom	700.00	3,800.00
Officers	1,500.00	8,500.00
Office	1,300.00	6,200.00

(9) An analysis of the Sales reveals the sales by each of the departments to be as follows:

Department A	$156,600.00
Department B	69,600.00
Department C	121,800.00

(10) An analysis of the Purchases Account indicates that this account contains the inventory at the beginning of the year, as well as the purchases during the year, and the amounts in respect to each department are:

	Inventory Beginning of Year	*Purchases*
Department A	$40,000.00	$121,500.00
Department B	15,000.00	54,000.00
Department C	21,000.00	94,500.00

(11) You discover that no physical inventory has been taken. However, the records are maintained in a manner which will enable you to ascertain the inventory on the basis of the retail method. You learn that seasonal verification of the items in stock has been made. Your investigation of the records discloses the following additional information:

Departments	*A*	*B*	*C*
Inventory at beginning at retail	$ 50,000.00	$19,500.00	$ 28,200.00
Purchases during year at retail	153,375.00	71,200.00	127,000.00
Mark downs	1,500.00	1,000.00	1,200.00
Special allowances on contract sales	5,000.00	3,200.00	3,500.00

(12) You discover that the store is leased for a period of ten years, from July 1, 1932, and that no amortization of the improvements made at the time of occupancy has ever been charged off. You also learn that the store fixtures will have no value if this lease can not be renewed, and the office furniture has a remaining life of fifteen years. The delivery equipment was acquired in 1935 and the accrued depreciation to date is $580 including $200 for this year.

(13) According to the plan of the building, the floor space occupied by the various departments is as follows:

Department A	40%
Department B	20%
Department C	25%
Storeroom	10%
Office	5%

Required:

(a) The necessary closing journal entries and work sheet.

(b) Calculation of inventories at the end of year.

(c) Profit and Loss Statement for the year, including an analysis of departmental profits.

(d) Analysis of the Surplus Account.

(e) Calculation of State and Federal income taxes.

No. 12. The ABC Company, incorporated in Pennsylvania, controlling public utility companies operating in states along the Atlantic seaboard, was a party to the formation and incorporation of DEF Company under the laws of another state. The DEF Company subsequently also became a holding company controlling public utility companies operating in the state of incorporation and nearby states. The ABC Company acquired at the date of formation of the DEF Company and continued to hold from that date a voting control of the DEF Company by reason of ownership of 70 per cent of that company's outstanding common stock.

At December 31, 1934, a consolidation of the assets and liabilities of the DEF Company and its subsidiary companies produced, in part, the following:

Investment in fixed capital	$100,000,000
Excess of cost of investments in securities of subsidiary companies consolidated over par or stated value of subsidiaries securities owned and surplus at dates of acquisition	22,000,000
Consolidated earned surplus:	
Applicable to the DEF Company	16,500,000
Applicable to minority interests	500,000

Surplus at date of acquisition with respect to the DEF Company's investments in securities of subsidiary companies which were incorporated under the laws of the same state as the DEF Company was determined to be as follows:

G Company	$6,000,000	K Company	$ 5,000
H Company	1,000,000	L Company	50,000
I Company	300,000	M Company	75,000
J Company	50,000	N Company	150,000

The ledger value of the DEF Company's investment in G Company, consisting of common stock with a stated value of $40,000,000 was $63,000,000.

The company decided upon a plan of simplifying the capital structure of the group and confining its utility operations to the state of its incorporation.

On August 1, 1935, the DEF Company sold its holdings in subsidiaries which operated in states other than that of its incorporation, sustaining no loss on the sale of those investments. Continuing with its plan, the DEF Company, on September 1, 1935, merged with its largest wholly owned subsidiary, G Company, and common stock of G Company was issued share for share to holders of common stock of the DEF Company. After certain charges and adjustments, it was determined that the surplus of the DEF Company at date of merger with G Company aggregated $4,500,000. On October 1, 1935, the Board of Directors of G Company authorized an appropriation of $4,500,000 from surplus and the transfer thereof to the reserve for renewals and replacements.

During the year 1935, consolidated additions to fixed capital accounts aggregated $3,000,000, sales of property and equipment amounted to $4,000,000 and retirements to $7,000,000. The consolidated net income of the merged companies for the year ended December 31, 1935, was $12,000,000 and dividends paid for the year ended that date total $9,000,000, of which amounts $400,000 and $300,000, respectively, were applicable to minority interests.

Requirements:

(1) Prepare a schedule in columnar form showing the changes during the year 1935 and balances at December 31, 1935, of the following:

(a) Investment in fixed capital.

(b) Excess of cost of investments in securities of subsidiary companies consolidated, over par or stated value of subsidiaries securities owned and surplus at date of acquisition.

(c) Consolidated earned surplus applicable to the G Company.

(d) Consolidated earned surplus applicable to minority interests.

(2) What particular treatment at December 31, 1935, if any, should be given to the surplus acquired by G Company, as a result of the merger with DEF Company? Should this surplus be eliminated in consolidation?

(3) On December 10, 1935, the board of directors of G Company declared a dividend of $7,000,000 payable December 30, 1935, to holders of common stock of record December 15, 1935. Prior to the payment of the dividends the G Company had a balance of $8,000,000 in its surplus account. What treatment should be given the dividend accruing to the ABC Company as owner of 70 per cent of G Company's common stock?

EXAMINATION IN GENERAL ACCOUNTING
Friday, November 6, 1936 from 2 P. M. to 5 P. M.

No. 13. The Superior Carbon Paper Company manufactures three classes of carbon paper as follows:

Grade	*Material Cost Per Ream*	*Selling Price Per Ream*
Deluxe	$8.00	$12.00
Fine	6.00	8.50
Standard	4.00	5.00

The manufacturing processes are exactly alike, except that the running speed varies with the grade of tissue used. The comparative running speeds per roll of tissue (6 reams) are as follows:

Deluxe	3 hours
Fine	2 hours
Standard	1 hour

Variations in the number of finished reams per roll will occur owing to occasional defects in raw material. There is also considerable waste and spoilage due to improper adjustment of machines, carelessness of operators, etc.

Operators are paid 90 cents per hour and one operator is required for each machine. The shop foreman is paid a monthly salary. Employment is steady throughout the year.

The average monthly overhead of the shop is $6,000. The administrative overhead is $1,200 per month. The average monthly production of each grade of carbon paper is 2,000 reams.

At present the company has an ordinary double entry bookkeeping system. Trial balances are taken each month and operating statements prepared. The cost of sales is determined by applying to the total sales an estimated percentage of gross profit as indicated by past experience, but no attempt is made to determine the separate profit in each grade of carbon paper.

The president of the company feels that it would be advisable to have more accurate information concerning the manufacturing cost of the various grades of carbon paper. He engages you to install a cost system but suggests that before doing so you submit to him, in writing, a brief outline describing in simple language the type of system you propose to install with illustrations showing how you will compute the cost per ream of each grade.

Required:

Your letter to the president outlining the cost system which you would install in his plant, and indicating what other benefits might be derived in addition to the furnishing of cost data. Show a summary or list of the items which go to make up the full cost of a finished roll of paper.

Accounting record forms are not to be ruled up, but candidates will be graded on their choice of the correct system, the clarity of the outline of procedure, and the finished style of plan submitted.

No. 14. You are engaged on December 10, 1935 by the Textile Spinning Company, a corporation operating a spinning mill, to prepare statements reflecting the financial condition as at November 30, 1935 and the result of operations

for the eleven months then ended, with particular reference to profit or loss before interest and depreciation, for submission in support of a loan application. Banks holding notes of the company have agreed to subordinate their notes to the proposed loan. The books were last closed on December 31, 1934, are kept on the accrual basis, and have been posted to November 30, 1935. Cost accounts and perpetual inventory accounts are maintained in the general ledger. There are no subsidiary ledgers except Accounts Receivable and Accounts Payable. The following trial balance of the general ledger was taken at November 30, 1935:

	Debits	*Credits*
Cash in bank	$ 11,461.20	
Petty cash	286.98	
Accounts receivable—Trade	45,594.65	
Accounts receivable—Officers	17,710.49	
Accounts receivable—Employees	1,146.28	
Inventory—Raw material	414.33	
Inventory—Work in process	753.90	
Inventory—Mill waste	382.68	
Inventory—Finished yarns	5,706.92	
Building and loan association shares (cost)	1,014.80	
Rayon development	4,602.40	
Treasury stock (280 shares preferred) (cost)	28,000.00	
Goodwill	1.00	
Land (cost)	25,000.00	
Buildings (cost)	87,628.13	
Machinery and equipment (cost)	159,548.82	
Prepaid insurance		$ 459.70
Prepaid interest	9.67	
Notes payable—banks		132,648.80
Accrued wages	393.65	
Accrued taxes		103.07
Accrued interest on mortgage		230.00
Accrued salaries		1,780.01
Accounts payable		2,356.07
Mortgage payable		10,000.00
Preferred stock (1,000 shares, par $100 each)		100,000.00
Common stock (500 shares, par $100 each)		50,000.00
Reserve for depreciation—buildings		31,891.44
Reserve for depreciation—machinery and equipment		112,071.59
Deficit	18,115.88	
Distribution of overhead expenses		50,039.13
Cost of raw material used	14,591.44	14,591.44
Cost of Mill Waste used	353.20	353.20
Cost of imported rayon yarn used	513.19	513.19
Cost of finished yarn manufacturing	61,461.08	61,461.08
Cost of goods sold	65,394.97	
Bad debts written off	12,161.15	
Discount on sales	316.32	
Wool oil purchases	225.41	225.41
Wool scouring	639.98	639.98
Raw stock dyeing	14.40	14.40
Inbound transportation	440.27	
Payroll	17,762.80	18,156.45
Superintendence	8,202.20	
Direct labor	9,612.90	
Power and light	2,047.86	
Insurance	987.62	
Taxes — real estate	109.77	
Forwarded	$602,606.34	$587,534.96

	Debits	Credits
Brought forward	$602,606.34	$587,534.96
General factory expense	2,363.83	
Laboratory expense	312.00	
Shipping supplies	84.07	
Heat	1,711.40	
Mill supplies	33.79	
Repairs—building and machinery	211.12	
Salaries—sales	3,965.51	
Traveling expense	4,016.60	
General administrative expense	2,241.00	
Taxes—capital stock	337.23	
Office expense	1,021.99	
Telephone and telegraph	541.76	
Depreciation—buildings	2,969.09	
Depreciation—machinery and equipment	5,177.73	
Interest on mortgage	450.00	
Sales		37,289.04
Miscellaneous income		406.90
Interest earned		2,812.56
Totals	$628,043.46	$628,043.46

Question (a) to (f):

(a) Which accounts in the trial balance reveal an unusual condition as regards balance?

(b) What method would you use to analyze cost accounts?

(c) List the accounts which would be eliminated by adjusting entries on your working trial balance as a result of such analysis.

Your audit discloses the following facts requiring adjustment:

(1) Journal entry debiting "Payroll" $393.65 and crediting "Accrued Wages" was posted erroneously with the accounts reversed.

(2) In 1934 "Legal Expense" was debited and "Accounts Payable" credited in the amount of $1,000 for attorney's fees in connection with the settlement of an account receivable. The gross amount of the settlement was entered in cash receipts in 1934 although the attorney deducted his fee when remitting the proceeds.

(3) Invoice for fire insurance premiums, $459.70, has not been entered upon the books. The policy has been entered in the insurance record and the proper amount charged to "Insurance" and credited to "Prepaid Insurance," monthly. All insurance is one year term, expiring November 30.

(4) The Accounts Payable control has exceeded the detail by $954.90 for six years, without change.

(5) Cash, $8,356.64, on deposit in a closed bank, was applied by the bank against notes payable.

(6) "Employees Accounts Receivable" includes $310.00 due from an officer of the company.

(7) Accounts payable not entered at November 30, 1935, comprise invoices for the following:

General Factory Expense	$ 69.89
Mill supplies	58.73
Raw wool	472.43
Heat	290.68
Total	$891.73

(8) Petty cash includes vouchers for general administration expenses totaling $240.

(9) Motor trucks, fully depreciated and discarded, are included in fixed assets at cost of $4,888.

(10) Interest aggregating $2,812.56 was accrued on an account receivable of doubtful collectibility, and charged to "Accounts Receivable."

(11) "Accrued Salaries" comprise erroneous accruals of Sales Salaries, $1,480.02, and Superintendence, $299.99.

(12) Accrued interest payable on mortgages, not on books, amounts to $203.33.

(13) Undistributed wages at November 30, 1935 comprise:

Superintendence	$141.70
Labor	219.20
General factory expense	32.75
Total	$393.65

(14) Accounts receivable aggregating $8,914.75 are to be written off as uncollectible.

(15) General administrative expense includes salaries of $1,500.

(d) Prepare the adjusting Journal Entries, without explanations. The composite journal entries affecting cost and inventory accounts during the period, were as follows:

	Debit	*Credit*
Work in Process	$66,377.35	
Distribution of Overhead Expenses		$50,039.13
Inventory—mill waste		.30
Cost of raw material consumed		14,591.44
Cost of imported rayon yarn used		513.19
Cost of waste used		353.50
Wool oil purchases		225.41
Wool scouring		639.98
Raw stock dyeing		14.40
Cost of finished yarn manufacturing	61,461.08	
Work in Process		61,461.08
Yarn inventory	61,461.08	
Cost of finished yarn manufacturing		61,461.08
Cost of goods sold	65,394.97	
Yarn inventory		54,778.79
Work in process		4,015.43
Yarn inventory (write down from Cost to Market)		6,600.75

(e) Prepare the adjusting entries, without explanation, required for your working trial balance, to permit preparation of profit and loss statement.

The following notes on the audit are to be considered:

Cash in bank—$1,431.34 is in closed banks.

Doubtful trade accounts receivable total $27,484.55.

Doubtful employees accounts receivable total $363.65.

Accounts receivable—Officers—Comprise advances to be repaid out of future salaries or dividends.

Rayon spinning is a new line developed within the last year.

Extension agreements in the aggregate amount of $124,292.16 have been executed by notes payable creditors who have also waived interest.

$53.33 of Interest on Mortgage Payable is applicable to prior year.

All bad debt losses arose from sales of prior years.

Raw material purchases during the period aggregated $12,066.51. Imported rayon yarn sold, cost $513.19, with no rayon yarn purchases during the period.

Mill waste transferred from "Work in Process" to "Inventory—Mill Waste" during the period, aggregated $646.94.

Inventories at beginning and end of the period were as follows:

	January 1, 1935		November 30, 1935	
Raw Material				
Wool	3,192.42		721.13	
Rayon	219.27		165.63	
		3,411.69		886.76
Mill Waste		89.54		382.98
Work in Process		500.00		753.60
Finished Goods				
Yarn Inventory	5,070.00		5,151.54	
Imported rayon yarns	1,068.57		555.38	
		6,138.57		5,706.92

(f) Prepare statements of Assets and Liabilities, Manufacturing, Trading, Profit and Loss, and Deficit Account. You may assume that Receivables and Payables have been verified by correspondence, that inventories are correct and priced at cost or market, whichever is lower, and that depreciation, prepayments and accruals, not commented upon heretofore, have been properly calculated.

Note: A weight equivalent to two questions (14 and 15) will be given to this question.

EXAMINATION IN COMMERCIAL LAW

Saturday, November 7, 1936 from 9 A.M. to 1 P.M.

Study the questions carefully before writing your answers. Do not repeat the questions as printed. Give reasons fully—which means give the rules of law applicable and show how they produce your result. Answers without disclosure of the legal reasoning involved will receive NO CREDIT.

1. (a) Plaintiff applied to defendant's agent for a policy of fire insurance on a supply of merchandise owned by plaintiff. The agent replied, advising him of the terms, and added, "Should you desire to effect the insurance, send me your check payable to my order for $57.00 and the business is concluded." This letter reached the plaintiff on the 20th. He posted an acceptance on the 21st. The letter of acceptance was received on the 31st and the goods had been destroyed by fire on the 22nd. Explain whether or not there was a contract of insurance between the parties, and if so, on what date.

   (b) Plaintiff purchased a gas station from the defendant. Nothing was said about any restriction upon the seller engaging in the same business at any time or place. After the sale had been concluded the defendant orally promised not to compete with the plaintiff in the same business in the same town for 5 years. Is this agreement valid and enforceable?

2. (a) Discuss briefly the treatment of capital gains and losses under the Federal Revenue Act of 1936 for income tax purposes.

   (b) "A" sells capital assets costing $2500 for $3000 in cash. If such assets were owned less than one year, what percentage of the profit should be reported for income tax purposes? What if held for over one year?

   (c) "B" sells capital assets costing $8000 for $5000 in cash. If these assets were owned less than one year what loss may be claimed for income tax purposes, assuming no capital gains to exist in this year? What if owned for over one year?

3. (a) What incidents are to be considered in determining the existence of a partnership?

   (b) Defendant secured rooms, furniture, and goods suitable for a grocery store, and installed the plaintiff as manager, under an agreement that, after the net receipts should repay the cost of the original investment, maintenance, and board and room of the plaintiff and defendant, plaintiff who was to receive in the meantime no other compensation, should be a partner with a one-half interest in the business. After a profitable continuance of the business for two years and just a month before the receipts would have repaid the defendant, the defendant repudiated the agreement and sold the business at a large profit to Z. Explain whether the plaintiff should file a bill in equity for an

accounting between partners, or should institute a common law action to recover wages for his services.

(c) What rules govern the distribution of the assets of a partnership and of individual partners, when all become insolvent?

4. (a) Outline the steps which are necessary to organize a business corporation in Pennsylvania to the point where it may properly begin business.

(b) Outline the steps which are necessary to merge or consolidate two Pennsylvania business corporations **and also tell** when the merger or consolidation is effective, the effect of such merger or consolidation and the rights of dissenting stockholders.

5. (a) Stolen coupon bonds, payable to bearer, were pledged as collateral security for a loan by a bank to the thief, in the ordinary course of business, without notice of any infirmity in the title. Explain whether or not the bank acquired good title as against the person from whom they were stolen.

(b) "A" made a note payable to the order of "B," 30 days after date, payable at the X Bank, for goods purchased by "A." On the due date "A" had ample funds on deposit at the X Bank to pay the note but had said nothing to the Bank about the note. "B" waited in the lobby of the X Bank the whole of banking hours on the due date but "A" not appearing, "B" went home without doing anything further. The next day the Bank failed. What are the rights of "B"?

6. H and W, husband and wife, opened a bank account in the X Bank as follows:
"In account with H and W, husband and wife, either to have the right to draw on separate checks signed by either."

(1) Can C, a judgment creditor of H, attach the funds in this account?

(2) If H were to die, would the account be payable to W or to H's executor?

(3) Could D, holder of a judgment against H and W, entered on a bond accompanying a mortgage given by H and W on a farm owned by them, attach the funds in this account?

(4) Would there be any inheritance tax due the State of Pennsylvania on the death of either H or W?

7. T was trustee of an estate in which L had a right to receive the income thereon for life, after which the principal was to be paid to R. T properly bought certain bonds calling for repayment of \$100 per bond for which T paid the prevailing market price of \$105 and paying 5% interest. T properly bought certain other bonds calling for repayment of \$100 per bond at \$95—the prevailing market price—and paying 5% interest. The life beneficiary is now 25 years old and the bonds are non-callable and due in 25 years from the date of purchase. Explain to T the

proper accounting procedure to accurately state operating results and financial condition of the trust on these bonds. Also explain to T whether or not your suggestions represent the law of Pennsylvania on the subject.

8. Answer the following question "Yes" or "No" with one sentence explanation of your answer.

   (1) B, having assets of $5000 and liabilities of $1000, files a voluntary petition in bankruptcy. Should it be granted?

   (2) B, who has committed an act of bankruptcy, owes A $250 and D $200 and is being sued by C for $1000 for personal injuries caused by B's negligence. Can B be adjudged an involuntary bankrupt?

   (3) A had knowledge of, but not formal notice of, B's voluntary petition in bankruptcy, which did not list A's proveable claim as a liability. After B's discharge, A sues B on the claim. Can he recover?

   (4) A having a proveable claim files it 9 months after B's adjudication as a bankrupt, before B's estate is settled. Should it be allowed?

   (5) May A, a secured creditor of B, join other creditors in an involuntary petition in bankruptcy against B?